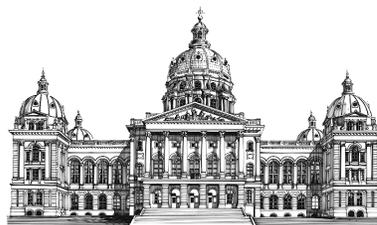

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Student Loan Default Prevention Activities by the College Student Aid Commission

ISSUE

Since the passage of the federal Balanced Budget Act of 1997, the College Student Aid Commission has been required to expend interest received on certain loan reserves to provide enhanced student loan default prevention activities. The General Assembly attempted, through intent language in FY 1999 and FY 2000, to have input in how the Commission utilized the interest funds. However, the intent language was vetoed for both years. This **Issue Review** examines the federal requirements and the Commission's actual and proposed activities relating to default prevention.

AFFECTED AGENCIES

College Student Aid Commission

CODE AUTHORITY

Chapter 261, Code of Iowa

BACKGROUND

The federal Balanced Budget Act of 1997 requires the return of nearly \$1.0 billion of student loan guaranty agency reserves to the federal treasury by the end of FFY 2002. The Iowa College Student Aid Commission's share of these reserves is approximately \$30.5 million. The reserves are to be deposited to a special recall or "set-aside" account over a five-year period. The first of the five installments of approximately \$6.0 million was made to Iowa's recall account in December 1997, and the final installment will be made in December 2001.

Per federal law, a second account has been established by the Commission for deposit of interest earned on the recall account. The Commission is allowed to use the interest earnings for enhanced loan default reduction activities. Enhanced default reduction activities are described as activities beyond those required of guarantors by federal regulation. Commission staff estimate that approximately \$4.8 million in interest will be earned over the five-year period.

The U.S. Department of Education has not provided specific guidelines regarding how the interest earnings are to be used. However, the Department did provide the following examples of permissible uses:

- ◆ Partial loan cancellation for good repayment performance.
- ◆ Debt management and job placement counseling for “high-risk” borrowers.
- ◆ Development of public service announcements that detail the consequences of default.

The Department also stated the funds should be used to provide “additional assistance for disadvantaged and high-risk borrowers.”

CURRENT SITUATION

In response to the federal requirements, the Iowa College Student Aid Commission created a Default Reduction Task Force to provide input regarding how the interest earnings should be utilized. Membership of the Task Force consists of 11 financial aid personnel from Iowa higher education institutions.

Based on recommendations from the Task Force, the Commission has approved commitments through FY 2001 as illustrated in **Table 1**.

Table 1
Commission Default Activity Commitments Through FY 2001

<u>Commitment</u>	<u>Amount</u>
Default Reduction Task Force (\$2,500/year)	\$ 7,500
Default Reduction Materials for Financial Aid Officers	2,500
Student Status Management System	10,000
Default Aversion Counselor (\$75,000/year FY 2000-2001)	150,000
Foster Child Grant Program	300,000
Debt Management Grants (proposed)	1,000,000
Total Commitments (actual and proposed)	<u>\$ 1,470,000</u>
Estimated funds available FY 1998 through FY 2001*	<u>\$ 2,900,000</u>
Non-committed Funds	<u>\$ 1,430,000</u>

*Assumes deposit of \$6.0 million each December at 6.0% rate.

Other commitments under consideration by the Task Force and the Commission include:

- ◆ Debt Management Grants. This concept, based on a successful program at the University of Texas Pan American, is designed to reduce defaults by delaying a borrower’s reliance on student loans until completion of the freshman year. Statistically, borrowers that successfully complete the freshman year are much less likely to default than those students that drop out during the first year. To receive a debt management grant, a student would have to agree not to borrow during the first academic year.
- ◆ Repayment Assistance Program. This Program would provide monetary assistance to delinquent borrowers prior to default. Examples could include:

- ◆ Supplementing student loan payments for a period of time if the borrower is receptive to credit counseling and demonstrates potential for repayment.
- ◆ Making temporary interest-only payment for borrowers who have exhausted the economic hardship deferment eligibility.
- ◆ Purchasing loans for borrowers with high debt-to-income ratios and arranging income contingent repayment plans to facilitate payment.
- ◆ Making three to six full payments on behalf of a borrower and forgiving the payments if the borrower makes subsequent payments for an agreed upon time.
- ◆ Assisting defaulted borrowers with monthly payments to allow the borrower to earn the right to rehabilitate defaulted loans and avoid adverse credit reports.

The challenge for Commission staff with any default prevention proposals is to identify borrowers who are “willing but unable” to pay as opposed to those that are “able but unwilling” to pay.

ALTERNATIVES

The General Assembly has attempted to provide input to the Commission regarding use of the interest funds for default prevention. In both HF 2533 (FY 1999 Education Appropriations Act) and SF 464 (FY 2000 Education Appropriations Act), the General Assembly included intent language that directed the Commission to use the interest funds for emergency loans to assist needy students to avoid default. Governor Branstad vetoed the language in HF 2533 and Governor Vilsack vetoed the language in SF 464. In addition, both HF 2533 and SF 464 contained changes to the Code of Iowa that prohibited the Commission from expending the interest funds unless appropriated by the General Assembly. Both statutory changes were also vetoed.

The General Assembly may wish to continue to provide input to the Commission either through additional legislation or by creation of a study committee or advisory council. The estimated interest earnings of \$4.8 million over a five-year period is a significant amount to be expended at the discretion of the Commission without input or oversight on the part of the General Assembly.

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